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TRANSFERS IN CONTEMPLATION OF DEATH — THE GOLDEN ANNIVERSARY OF CHAOS

The devil himself . . . knoweth not the mind of man; and even if he did, the devil's advocate might experience considerable difficulty in proving it to a court of law.

— Mr. Justice Frankfurter¹

I. INTRODUCTION

Congress has long recognized that taxpayers with large amounts of money and property avoid the operation of the estate tax laws and higher tax rates by making inter vivos gifts in contemplation of death. Yet, from the inception of the federal estate tax in 1916, statutory provisions including the value of such transfers as part of a decedent's gross estate have proven to be a constant source of litigation and resulting frustration to the federal government. The notable lack of success which the government has had in this area is abundant proof that an alternative to the present law is necessary. Without the enactment of such an alternative, application of the estate tax to gifts which, in effect, amount to testamentary dispositions made during the taxpayer's lifetime will never been accomplished.²

It is the purpose of this article to trace the development of federal estate tax law from its inception in 1916 to the present, with a view toward demonstrating the confusion and inequity which presently characterizes the area. Evidentiary considerations and the motives of the transferor to which the courts have given special attention shall also be examined in some detail. Finally, some of the more prominent alternatives suggested by authorities in this field will be considered.

II. LEGISLATIVE DEVELOPMENTS: 1916 — 1966

The Revenue Act of 1916³ established a *rebuttable presumption* that transfers of a *material* part of the decedent's property made within two years of his death were in contemplation of death and includible in his gross estate. In the ten year period during which this Act was in effect, the government was successful in approximately 20 percent of the litigation involving a total of less than \$5,000,000 but lost the vast majority of the cases which involved gifts in excess of \$120,000,000. In 1926, Congress, recognizing the inadequacies of the 1916 Act, enacted section 302(c) of the Revenue

1. FRANKFURTER, LAW AND POLITICS 55 (1939).

2. See Pavenstedt, *The Limitation of Taxation of Transfers in Contemplation of Death by the Revenue Act of 1950*, 49 MICH. L. REV. 839, 841-47 (1951), for a statistical listing of the government's unsuccessful litigation in this area which prompted the 1950 change and which is currently in effect.

3. INT. REV. ACT, ch. 463, § 202(b), 39 Stat. 777-78 (1916).

Act⁴ which created a *conclusive presumption* that gifts made within two years of death were to be deemed made in contemplation of death. An indication of how long this section was to survive came only three days after the passage of the Act when the Supreme Court held a Wisconsin statute which contained a similar six year irrebuttable presumption invalid under the fourteenth amendment.⁵ In *Heiner v. Donnan*,⁶ the Court held the federal provision unconstitutional because its enforcement resulted in taxing some inter vivos transfers under the estate tax while exempting others of a similar nature — the distinction between them being based solely upon the date of the transferor's death. Such a presumption was held to be an unreasonable classification and thus violative of the due process clause of the fifth amendment.

As a result of the *Donnan* decision, Congress in 1932 reverted to the rebuttable two year presumption affecting all transfers of a "material part" of the transferor's property.⁷ Once again the government found itself losing far more cases than it was able to win. In order to eliminate much of this fruitless litigation, section 501(a) of the Revenue Act of 1950 (now section 2035(b)) was enacted, providing that gifts made more than three years prior to the donor's death were to be conclusively presumed as *not* being in contemplation of death. At the same time, the period of the rebuttable presumption was extended from two to three years.⁸ Existing case law was not basically changed by the 1950 amendment although its applicability, was limited to those transfers which are followed by the transferor's death within the three year period.

III. JUDICIAL DEVELOPMENTS; THE *Wells* CASE AND THE TREASURY REGULATIONS

A. *United States v. Wells*⁹

The ultimate test of whether a transfer has been made in contemplation of death is not the form of the transfer as determined by an objective standard, but rather the subjective state of mind of the transferor at the time of the transfer. This subjective test requires a court, in effect, to read the mind of a dead man. As the late Randolph E. Paul noted: "too much should not be expected of the courts, for they are presented in most cases with carefully assembled evidence in proof of motive, which is a highly elusive, subjective test of taxability."¹⁰

4. INT. REV. ACT, ch. 27, § 302(c), 44 Stat. 70 (1926). The passage of this Act was concurrent with the repeal of the federal gift tax and was viewed as the only means by which avoidance of gift taxes could be prevented.

5. *Schlesinger v. Wisconsin*, 270 U.S. 230 (1925).

6. *Heiner v. Donnan*, 285 U.S. 312 (1931). The vitality of this case shall be considered in a subsequent section.

7. INT. REV. ACT, ch. 209, § 803(a), 47 Stat. 169, 279 (1932).

8. INT. REV. ACT OF 1950, § 501(a); INT. REV. CODE OF 1954, § 2035(b).

9. 283 U.S. 102 (1931).

10. PAUL, FEDERAL ESTATE AND GIFT TAXATION 279 (1942).

In *United States v. Wells*,¹¹ the Supreme Court attempted to define the scope of the phrase "in contemplation of death." The Court found that the dominant purpose of the tax on transfers in contemplation of death was to reach substitutes for testamentary dispositions, and therefore, to prevent evasion of the estate tax.¹² The lower court's determination that "contemplation of death" required a present apprehension of death from some condition or peril which exists at the time of the transfer and which is the direct cause of such transfer was rejected. The Court specifically held that transfers in contemplation of death are not limited to gifts causa mortis, but that the statutory language embraced gifts inter vivos even though they are fully executed and are irrevocable and indefeasible.¹³

Turning to the meaning of "in contemplation of death," the Court noted that the necessary motive is not lacking merely because the transferor is not conscious of the fact that death is imminent. While the statute refers to contemplation of death, it does not necessarily require the contemplation of imminent death;¹⁴ the general expectation of death which all men entertain is insufficient to meet the statutory language.¹⁵ A *particular concern* about death which gives rise to a definite motive which is the dominant or impelling reason for the transfer, is necessary — a motive which falls somewhere between the apprehension of imminent death and the general expectation of death which all men entertain. Considering the vague and abstract nature of this distinction, it is not difficult to appreciate the problems which most courts have had in attempting to determine the motive of the transferor.

B. *The Treasury Regulations*

Following the *Wells* decision, the Internal Revenue Service sought to clarify the language of the Supreme Court. Although the present Treasury Regulations purport to follow the Supreme Court's interpretation of the statutory language, a question arises with regard to whether certain changes have been made. The Regulations provide in part that:

A transfer in contemplation of death is a disposition of property prompted by the thought of death (*although it need not be solely so prompted*). A transfer is prompted by the thought of death if (1) made with the purpose of avoiding death taxes, (2) made as a substitute for

11. 283 U.S. 102 (1931).

12. *Id.* at 116. However, Professor Lowndes has challenged the validity of such a finding. He finds that the purpose of the statute is to tax intestate as well as testate succession and that Congress was really aiming to reach transfers by one who shortly before his anticipated death disposed of his property so as to defeat the tax on either testate or intestate succession. Under this view, it would be a conscious realization of nearing death, not a testamentary intent, which would differentiate a transfer in contemplation of death from other inter vivos transfers. Lowndes and Rutledge, *An Objective Test of Transfers in Contemplation of Death*, 24 TEXAS L. REV. 134, 146 (1946).

13. 283 U.S. 102, 116 (1931).

14. *Id.* at 117.

15. 283 U.S. 102, 115 (1931).

a testamentary disposition of the property, or (3) made for any other motive associated with death.¹⁶

As the Supreme Court pointed out in *Wells*, the thought of death must be the "dominant" or "controlling" motive for the transfer in order to fall within the statutory language. However, it would appear that, under the above Regulations, a transfer is in contemplation of death if it is prompted by *any motive* associated with death, even though it may be more strongly prompted by other motives which are clearly associated with life. A further difference is the provision that a transfer made to avoid estate taxes is a transfer in contemplation of death — a consideration which was not discussed in *Wells*. Such overt differences between the landmark decision in the area and the Treasury Regulations which purport to implement this decision give little illumination to the courts struggling in the darkness of confusion and uncertainty.

C. *The Court's Struggle*

It should be quite clear at this point that the motive of the decedent is crucial with regard to transfers in contemplation of death. The courts must seek to unfold the transferor's subjective state of mind by directing their inquiry to the plethora of circumstantial factors attending the transfer. It must be recognized that in attempting to ascertain whether a particular transfer was made with a "life" or a "death" motive, the answer, even after a full examination of the facts, may continue to remain obscure. All too often it lies in a gray area where there may be distinctions without differences and where the final decision seems about as sensible as if it had been determined by a flip of the coin or by the drawing of straws between the government's attorney and the attorney for the estate. Nevertheless, the courts must examine the relevant facts of each case and make a determination as to what probative value such evidence should be given. In this respect it is helpful to consider how the courts have generally handled such cases and to categorize this litigation by its distinguishing features.

Basically, there are two distinct classes to which the courts have directed their attention. First, there are the objective or evidentiary factors which concern the transfer itself, for example, the amount of the transfer, the age of the transferor. Secondly, there are the factors which aid the courts in defining the dominant motive of the transferor at the time of the transfer. In most cases, the courts must necessarily infer the transferor's state of mind from the objective facts presented in evidence. While every possible objective fact used in such cases cannot be listed, there are certain basic facts to which the courts usually turn in reaching a decision.

1. *Age and Health of the Decedent*. — In certain instances, these two factors alone may be sufficient to defeat the transfer, especially where no

16. Treas. Reg. § 20.2035-1(c) (1949).

impelling life motive can be established.¹⁷ The health or physical condition of the decedent is usually given greater weight by the courts. While the element of old age may be overcome by evidence of the decedent's mental outlook, physical activities and business interests, serious illness is a more difficult obstacle to overcome. It is not unusual to introduce evidence of the transferor's ability to jump into the air and click his heels despite the fact that he is in his middle eighties.¹⁸ Even more significant is the transferor's awareness of his true physical condition at the time of the transfer. If he knew that he was suffering from a serious or fatal disease, then it is clear that the transfer was in contemplation of death. However, if he was not aware of his true condition, a closer question arises as to the importance of this factor.¹⁹

2. *Size of transfer.* — The present law eliminates the previous requirement that a transfer involve a "material portion" of the transferor's estate. It therefore would appear, that the size of the transfer should have little relevance with regard to whether it was made in contemplation of death. Moreover, one writer has suggested that if there is such a relationship, it is in inverse proportion to the size of the gift, inasmuch as the government's success in such cases diminishes as the size of the transfer increases.²⁰ Perhaps this is due to the fact that the larger estates can afford attorneys who are skillful in assembling the relevant evidence.

3. *Closeness of date of transfer to date of death.* — While this factor merits consideration, its evidentiary value may be easily surmounted by other more persuasive factors. One might expect the government to be more successful where death follows shortly after the transfer, but the results have been far from conclusive.²¹

4. *Nature of the property transferred.* — Where the property transferred will not produce income until after the transferor's death, a strong argument arises that the transfer is in the nature of a testamentary disposition. This is particularly true where the subject of the transfer is life insurance policies on the transferor's life.²² However, where compelling life motives can be attributed to the transfer of insurance policies, it has been held that the transfer was not in contemplation of death.²³

17. *Bassett v. Commissioner*, 170 F.2d 916 (2d Cir. 1948); *Koch v. Commissioner*, 146 F.2d 259 (9th Cir. 1944); *Flack v. Holtegel*, 93 F.2d 512 (7th Cir. 1937).

18. *Oliver Johnson v. Commissioner*, 10 T.C. 680 (1948).

19. *Blakeslee v. Smith*, 110 F.2d 364 (2d Cir. 1940); *Turner v. Hassett*, 37 F. Supp. 996 (D. Mass. 1941). In both cases the transferors had cancer but were unaware of this. In the former case, where the transferor was 73, it was held not to be in contemplation of death; while in the latter case where he was only 50 years old, it was so held.

20. *Atlas, Contemplation of Death: What It Is and How to Avoid It*, ESTATE TAX HANDBOOK 69, 75 (1951).

21. *Compare* *Edith H. Sharp*, 30 B.T.A. 532 (1934); 33 B.T.A. 290 (1935), where the government lost even though donor died one day after transfer, *with* *Henry M. Springer*, 45 B.T.A. 561 (1941), where the government won even though the donor was 75 and lived for 12 years after the transfer.

22. *Garrett v. Commissioner*, 180 F.2d 955 (2d Cir. 1950); *First Trust & Deposit Co. v. Shaughnessy*, 134 F.2d 940 (2d Cir. 1943), *cert. denied*, 320 U.S. 744 (1943).

23. *Cronin v. Commissioner*, 164 F.2d 561 (6th Cir. 1947); *Verne C. Hunt*, 14 T.C. 1182 (1950).

5. *Life or Death Motives.* — It is clear from the language of the *Wells* case that there must be a testamentary intent for a transfer to be in contemplation of death. The transfer must not be motivated, therefore, by some objective which the transferor wishes to achieve after his death. In this respect, the courts, in struggling to ascertain the existence or non-existence of the requisite testamentary intent, must necessarily determine whether the transfer was prompted by motives associated with life or with death.

Transfers to provide security for one's family in the face of business uncertainties or anticipated liabilities have generally been recognized as acceptable.²⁴ This is particularly true where the decedent may have wished his dependents to exercise the responsibility of managing the property during his lifetime.²⁵ Moreover, the recognition of a "moral obligation" to dependents may by itself, be a sufficient "life" motive, especially where the dependents have suffered financial setbacks or are otherwise in need of financial aid.²⁶ Other transfers — to promote family harmony,²⁷ to avoid income taxes²⁸ and to relieve the transferor of the responsibility of managing his property,²⁹ as well as those made as part of an established gift making policy,³⁰ have been determined not to be in contemplation of death.

As noted above, the desire to avoid or reduce income taxes is regarded by the courts as a motive associated with life. But it has been held, and the Regulations provide, that a transfer made to avoid estate taxes is a motive associated with death.³¹ This conclusion is based on the premise that the avoidance of estate taxes is so related to the distribution of the transferor's property after his death that it can only be a motive associated with death. However, the problem is not as clear-cut as the Treasury Regulations would make it appear. The Supreme Court has recognized that the decedent's awareness of estate tax savings will not be sufficient if living motives were the dominant factor in the gift.³² Moreover, the cases which appear to

24. *Becker v. St. Louis Trust Co.*, 296 U.S. 48 (1935); *Colorado Nat'l Bank v. Commissioner*, 305 U.S. 23 (1938); *O'Neal v. Commissioner*, 170 F.2d 217 (5th Cir. 1948).

25. *Herbert G. Lowe*, 38 B.T.A. 117 (1938). *Cf.* *Henry M. Springer*, 45 B.T.A. 561 (1941).

26. *Allen v. Trust Co. of Georgia*, 326 U.S. 630 (1946); *Cooney v. United States*, 218 F. Supp. 896 (D.N.J. 1963); *Lillie G. Hutchinson*, 20 T.C. 749 (1953).

27. *Gillette v. Commissioner*, 182 F.2d 1010 (9th Cir. 1950); *Terhune v. Welch*, 39 F. Supp. 430 (D. Mass. 1941).

28. *Becker v. St. Louis Union Trust Co.*, 296 U.S. 48 (1935); *Lockwood v. United States*, 181 F. Supp. 748 (S.D.N.Y. 1959).

29. *Welch v. Hassett*, 90 F.2d 833 (1st Cir. 1937), *aff'd*, 303 U.S. 303 (1938); *Tait v. Safe Deposit & Trust Co. of Baltimore*, 74 F.2d 851 (4th Cir. 1935).

30. *Percy B. Eckhart*, 33 B.T.A. 426 (1937), *appeal dismissed*, 91 F.2d 1010 (7th Cir. 1935).

31. *Farmers Loan & Trust Co. v. Bowers*, 98 F.2d 794 (2d Cir. 1938), *cert. denied*, 306 U.S. 648 (1939); *Treas. Reg. § 20.2035-1(c)* (1949).

32. *Allen v. Trust Co. of Georgia*, 326 U.S. 630 (1946). But if the dominant motive is to avoid estate taxes then the transfer will be in contemplation of death. *Edwin W. Rickenberg*, 11 T.C. 1 (1948), *aff'd* on this issue, 177 F.2d 114 (9th Cir. 1949), *cert. denied*, 338 U.S. 949 (1950).

follow the Regulations on this point have used testamentary intent as the sole criterion of whether the transfer was made in contemplation of death, while disregarding the transferor's age, his health and his consciousness of imminent death. A court taking this position would have difficulty in finding a transfer not to be in contemplation of death when made by a wealthy and robust athlete of thirty who makes the transfer for the sole purpose of avoiding estate taxes in the future. Such a result would pervert the underlying reasons for taxing transfers in contemplation of death and, in addition, would be contrary to the congressional policy of leaving to the taxpayer the option of disposing of his property during his lifetime and paying a gift tax, or having the property distributed after his death and incurring an estate tax.

Another inquiry which courts must undertake is with regard to whether a transfer was intended as a substitute for a testamentary disposition. An important objective fact which tends to establish the transferor's testamentary intent is the making of the gift at the same time that a will is executed, particularly where the two transactions show an integrated plan for the disposition of the taxpayer's property.³³ Where a will is made subsequent to the transfer of property, there may still be evidence of a general testamentary scheme.³⁴ However, it has been held that no *inference* may be drawn from a will subsequently made, and that a testamentary intent may not be predicated upon a correlation with prior gifts which were themselves primarily non-testamentary.³⁵ In any event, where the dominant motive for the transfer is one associated with life, the simultaneous execution of a will would have little evidentiary value.³⁶

IV. THE SEARCH FOR AN ALTERNATIVE

In an area where such confusion and chaos reign, it may be some consolation to know that there is unanimity on at least one point — a change in the present standard is necessary. Several proposals have been made over the years, each of which merits consideration in order to determine which, if any, offers a more satisfactory standard.

The American Law Institute in its model estate tax statute has proposed that the present statutory scheme of a three year rebuttable presumption be extended to a period of five years. In the alternative, it suggests that all transfers within three years of death be subjected to the estate

33. *O'Neal v. Commissioner*, 170 F.2d 217 (5th Cir. 1948); *Diamond v. Commissioner*, 159 F.2d 672 (2d Cir. 1947); *Purvin v. Commissioner*, 96 F.2d 929 (7th Cir. 1938), *cert. denied*, 305 U.S. 626 (1938); *Igleheart v. Commissioner*, 77 F.2d 704 (5th Cir. 1935).

34. *Davidson v. Commissioner*, 158 F.2d 239 (10th Cir. 1946).

35. *Garrett v. Commissioner*, 180 F.2d 955 (2d Cir. 1950).

36. *United States Trust Co. of New York v. United States*, 23 F. Supp. 476 (Ct. Cl. 1938), *cert. denied*, 307 U.S. 633; *James Gilbert*, 14 T.C. 349 (1950).

tax.³⁷ The former suggestion is of little aid in reducing uncertainty inasmuch as it retains the subjective standard and the other elements which the courts are presently bound to examine. In reality, its only value will be to make more estates subject to the charge that the transfer was made in contemplation of death. Assuming the government's percentage of success remains at its current low level, the extension may provide some additional revenue but the same problems will remain. The Institute's second proposal of creating a three year period within which all transfers will be deemed to be in contemplation of death warrants greater consideration.

Although this proposal is based on a conclusive presumption similar to that held unconstitutional in *Donnan*,³⁸ it is doubtful that it would meet the same fate, if enacted, since in the *Bullard*³⁹ case, decided subsequent to *Donnan*, the Supreme Court held it constitutional to tax a strictly inter vivos transfer under the estate tax where this was a reasonable means of preventing avoidance of the tax. While this alternative eliminates the uncertainty of the subjective standard and the threat of "carefully assembled evidence," it fails to take into consideration the circumstances surrounding the transferor's death, his age, health or motives at the time of the transfer. This inflexibility may prevent its enactment into law.

The late Randolph E. Paul suggested in his treatise⁴⁰ that a statute be enacted which would provide for a conclusive two year presumption if several conditions were found to be present. Such a presumption would operate where the transferor had reached a *specified minimum age and had made a transfer of a substantial part of his property to heirs or natural objects of his bounty*. The merits of this proposal are obvious. It would provide the government with an effective and certain tool to implement the underlying congressional policy and at the same time prevent such arbitrary results as would arise under a purely conclusive presumption. There might be serious difficulties, however, in agreeing upon a minimum age requirement and what would constitute a "substantial" part of the transferor's property.

Another alternative worthy of consideration is the application of an *objective test to the transferor's motives*.⁴¹ A transfer would be deemed to be made in contemplation of death if a reasonable man in the transferor's position would have realized that he had no substantial life expectancy at the time of the transfer. This test, while clearly lacking the certainty of the proposals for a conclusive presumption, is in many respects a more desirable alternative to the present subjective test since it would eliminate the danger of "carefully assembled evidence." This objective test, however, would not

37. A.B.A.-A.L.I. MODEL FEDERAL INCOME, ESTATE AND GIFT TAX STATUTE (Tent. Draft No. 9) (1954).

38. 285 U.S. 312 (1932).

39. *Helvering v. Bullard*, 303 U.S. 297 (1938); *Helvering v. City Bank Farmers Trust Co.*, 296 U.S. 85 (1935).

40. PAUL, FEDERAL ESTATE AND GIFT TAXATION § 6.26 (1942).

41. Lowndes and Rutledge, *An Objective Test of Transfers in Contemplation of Death*, 24 TEXAS L. REV. 134 (1946).

result in any greater certainty than the subjective standard since it would involve a determination of what constitutes a "substantial life expectancy." It has been suggested that the objective test may be made more definite by use of the concept of constructive notice. Since there is an obvious relationship between one's age and his life expectancy, it is possible to determine the age at which a reasonable man would realize that he has no substantial life expectancy. This arbitrary age would function as a rule of inclusion rather than exclusion and would not protect transferors who have not reached the stated age and have a less than average life expectancy due to poor health.⁴²

Reference to the English method of handling inter vivos gifts provides a final alternative. In England, any disposition which is not made bona fide and complete five years prior to the donor's death is deemed to pass on his death, and is therefore included as part of his taxable estate.⁴³ However, the amount of the property included in the taxable estate is prorated according to the length of time the donor survives the date of the gift. Thus, if he survives for less than two years, 100% is included; if he lives for two years but less than three, 80%; three but less than four, 70%; four, but less than five, 40%.⁴⁴ While a day-by-day or month-by-month proration may be more effective, the basic concept of such an approach should be given serious consideration in the United States.

V. CONCLUSION

Until there is a complete integration of gift and estate taxes under a single transfer tax, the courts will, under the current law, continue to flounder in confusion upon the shoals of statutory and judicial ambiguity. Some of the proposed alternatives discussed above have merit and are worthy of more serious study; it is submitted that all of them are at the very least an improvement over the present state of the law.

Thomas J. Tomalis

42. *Id.* at 149-50.

43. FINANCE ACT, 1894, § 2(1)(c), 57 & 58 Vict., c. 30; CUSTOMS AND INLAND REVENUE ACT, 1881, § 38(2)(a), 44 & 45 Vict., c. 12; FINANCE ACT, 1910, § 59(1), 10 Edw. 7 & 1, Geo. 5, c. 35.

44. FINANCE ACT, 1960, 64, 8 & 9 Eliz. 2, c. 44.

EMPLOYER'S AND EMPLOYEE'S RIGHTS IN PATENTS ARISING FROM THE EMPLOYMENT

I. INTRODUCTION

The Patent Act of 1952 prohibits the issuance of a patent if any applicant "did not himself invent the subject matter sought to be patented."¹ Under this statute, only the discovering employee can obtain a patent for an invention which he has discovered during the course of his employment. The employee-inventor's rights have long been limited, however, by the doctrine that "where one is employed to make an invention and succeeds in accomplishing that task during the term of his service, the invention is the property of the employer, and the employee is bound to assign any patent which he may obtain to his employer."² Where the doctrine is applicable, the remedy of specific performance is available to compel an assignment should an employer be faced with an unwilling employee.³

Balancing between the two extremes of complete ownership by the employee and complete ownership by the employer, the courts have developed case-doctrine intended to provide substantial justice and to effectuate the intention of the parties. By dividing the legal situations into three main classifications — where a contract specifically provides for the employer's patent rights in an invention; where there is an express or implied contract to invent; and where there is only a general employment contract — a workable body of law may be obtained from the confusing myriad of cases.⁴

II. AN EXISTING CONTRACT SPECIFICALLY REGULATES THE PATENT RIGHTS IN ANY FUTURE INVENTIONS

As in any area of potential conflict, possible conflicts in patent claims can best be avoided by an agreement among the parties which specifies their respective rights. As a Michigan court stated in deciding that a complicated factual circumstance did not give rise to an implied contract to assign

1. 35 U.S.C. § 102(f) (1954). A limited exception is stated in 35 U.S.C. § 118 (1954):

Whenever an inventor refuses to execute an application for patent, or cannot be found or reached after diligent effort, a person to whom the inventor has assigned or agreed in writing to assign the invention or who otherwise shows sufficient proprietary interest in the matter justifying such action, may make application for patent on behalf of and as agent for the inventor on proof of the pertinent facts and a showing that such action is necessary to preserve the rights of the parties or to prevent irreparable damage. . . .

The applicant must also make an oath that he believes himself to be the "original and first inventor." 35 U.S.C. § 115 (1954).

2. 1 WALKER, PATENTS § 407 (Deller 2d ed. 1964).

3. Since *Mississippi Glass Co. v. Franzen*, 143 Fed. 501 (3d Cir. 1906), patent assignment contracts have been held subject to the remedy of specific performance. *Accord*, *Universal Winding Co. v. Clarke*, 108 F. Supp. 329 (D. Conn. 1952).

4. See RESTATEMENT (SECOND), AGENCY § 397 (1958). For an excellent article, see *Bishop, Employers, Employees, and Inventions*, 31 So. CAL. L. REV. 38 (1957). See also Cornfeld, *The Employer-Employee Relation in Patent Law*, 32 J. PAT. OFF. SOC'Y 345 (1950).

to the employer: "the case illustrates the advisability of reducing contractual relations to writing where the parties contemplate that any invention made by an employee during the course of his work shall belong to the employer."⁵ Recognizing this principle, companies which employ personnel likely to discover patentable inventions procure from such employees at the time of hiring, an assignment of any future patents which may be obtained by the worker. The standard clause refers to inventions "during the term of said employment related to the employer's business."⁶

Inasmuch as the desirability of such an arrangement presupposes the existence of an enforceable contract, it presents as much a question of contract law as of patent law. Thus it is necessary that the requirements of a valid contract — such as adequacy of consideration⁷ — be met. Neither can the contract be unconscionable;⁸ it must contain the necessary mutuality of remedy for specific performance,⁹ and its enforcement may be barred by the defense of laches.¹⁰

The requirement of an adequate consideration in the patent assignment contract between an employee and employer has usually been met. Generally, mere hiring or continued employment has been determined to be sufficient.¹¹

Furthermore, the standard patent assignment contract has not been found to be inherently unconscionable,¹² even in view of the fact that the company is usually in a much stronger bargaining position than the employee. This is true even though no royalties are given to the inventor under the contract and the invention is not used.¹³ However, if the agreement is not limited in time to the duration of employment or in subject matter to the business of the employer, unconscionability will result.¹⁴ It

5. *Gear Grinding Mach. Co. v. Stuber*, 282 Mich. 455, 276 N.W. 514, 516 (1937). For a treatment of these express contracts see ELLIS, *PATENT ASSIGNMENTS* ch. 13 (3d ed. 1955).

6. *E.g.*, *Rotary Lift Co. v. Clayton*, 127 F. Supp. 176 (D. Mass. 1954). While an assignment contract is usual, the same legal rules would apply to a license agreement. See *Woodruff v. New State Ice Co.*, 197 F.2d 36 (10th Cir. 1952); *Bowers v. Woodman*, 59 F.2d 797 (D. Mass. 1932).

7. *United States v. Dubilier Condenser Corp.*, 289 U.S. 178 (1933); *Corthell v. Summit Tred Co.*, 132 Me. 94, 167 Atl. 79 (1933) (adequate consideration not found).

8. *Guth v. Minnesota Mining & Mfg. Co.*, 72 F.2d 385 (7th Cir. 1934), *cert. denied*, 294 U.S. 711 (1935). See 19 MINN. L. REV. 485 (1935).

9. *Triumph Elec. Co. v. Thullen*, 228 Fed. 762 (E.D. Pa. 1916), *aff'd on other grounds*, 235 Fed. 74 (3d Cir. 1916).

10. *Gas Tool Patents Corp. v. Mould*, 133 F.2d 815 (7th Cir. 1943); *Reese Folding Mach. Co. v. Fenwiels*, 140 Fed. 287 (1st Cir. 1905).

11. *Patent and Licensing Corp. v. Olsen*, 188 F.2d 522 (2d Cir. 1951); *Hebbord v. American Zinc, Lead & Smelting Co.*, 161 F.2d 339 (8th Cir. 1947).

12. *Goodyear Tire & Rubber Co. v. Miller*, 22 F.2d 353 (9th Cir. 1927); *DuPont Rayon Co. v. Paley*, 4 F. Supp. 290 (N.D. Ill. 1933), *aff'd*, 71 F.2d 856 (7th Cir. 1934); *Briggs v. United Shoe Mach. Corp.*, 92 N.J. Eq. 277, 114 Atl. 538 (1920), *cert. denied*, 254 U.S. 653 (1920).

13. *Briggs v. United Shoe Mach. Corp.*, *supra* note 12.

14. *Guth v. Minnesota Mining & Mfg. Co.*, 72 F.2d 385 (7th Cir. 1934), *cert. denied*, 294 U.S. 711 (1935); *Pressed Steel Co. v. Hansen*, 137 Fed. 403 (3d Cir. 1905) (*dicta*). It should be noted that some cases speak of these contracts as being an unreasonable restraint of trade and thus contrary to our antitrust public policy, as well as being unconscionable. See, *e.g.*, *Chadeloid Chem. Co. v. H. B. Chalmers Co.*, 243 Fed. 606 (2d Cir. 1917).

is possible for a court to avoid the effects of the application of this general rule by construing the assignment — employment contract as divisible, separating the employment term from subsequent time periods, and holding the contract valid only as to inventions discovered during the period of employment.¹⁵

In most instances, the required assignment of unlimited subject matter patent rights for a limitless period of time will be held unconscionable *in toto*, while a required assignment for the period of employment will, if otherwise valid, be upheld. The crucial time limit separating validity from non-validity in cases falling between these two extremes is the somewhat nebulous "reasonable time after the termination of employment." The determination of a "reasonable time" is a factual question which will turn on the employee's type of work, the technique or art's status in the industry, and other relevant circumstances, as well as the extent of the time period itself. A one year extension of the requirement after employment has ended has been held valid,¹⁶ while a ten year period has been found to be unconscionable.¹⁷

As previously noted, the law finds unconscionability in the assignment of unlimited subject matter for a limitless period. The cut-off point for unconscionability relative to the assignment of subject matter, assuming an unlimited time clause, is also found in a reasonableness concept. There may be enforcement of a contract to assign inventions made after employment where the inventions are in a reasonably limited field,¹⁸ or in a specific limited line,¹⁹ or where the assignment is reasonably restricted, if such coverage is necessary for the protection of the employer's business.²⁰ A contract requiring a machine designer employed by a winding machine manufacturer to assign patent rights related to clutch designs, even though discovered after the termination of employment, has been held valid where the new designs were particularly pertinent to winding machines; a requirement to assign patents to inventions in the entire field of clutch design, however, would be invalid.²¹

The equitable remedy of specific performance demands that the contract possess mutuality of remedy. Thus, where the employment contract is for an indefinite time, specific performance of an assignment clause in the contract cannot be obtained, inasmuch as the assignor-employee could not obtain specific performance to force continued employment for a specific period of time.²²

15. *Guth v. Minnesota Mining & Mfg. Co.*, *supra* note 14.

16. *Universal Winding Co. v. Clarke*, 108 F. Supp. 329 (D. Conn. 1952).

17. *United Shoe Mach. Co. v. La Chapelle*, 212 Mass. 467, 99 N.E. 289 (1912).

18. *Universal Winding Co. v. Clarke*, 108 F. Supp. 329 (D. Conn. 1952).

19. *Dry Ice Corp. of America v. Josephson*, 43 F.2d 408 (E.D.N.Y. 1930).

20. *Chadeloid Chem. Co. v. H. B. Chalmers Co.*, 243 Fed. 606 (2d Cir. 1917); *Hulse v. Bonsack Mach. Co.*, 65 Fed. 864 (4th Cir. 1895).

21. *Universal Winding Co. v. Clarke*, 108 F. Supp. 329 (D. Conn. 1952).

22. *Triumph Elec. Co. v. Thullen*, 228 Fed. 762 (E.D. Pa. 1916), *aff'd on other grounds*, 235 Fed. 74 (3d Cir. 1916).

Laches, another equitable concept, may also bar the plaintiff-assignee where he unreasonably delays in bringing his action for enforcement, or leads the employee to believe that he is not interested in the particular invention.²³

If the general contract requirements have been met, the patent assignment clause in the employment contract will be upheld. In practice, as with the enforcement of any contract, as much depends upon the courts attitude of interpreting each type of contract as upon the theoretical legality of the agreement. As the basis of patent law is to provide an incentive to inventors, judges generally are reluctant to imply an agreement to assign,²⁴ although once an agreement is found, the provisions are broadly applied.²⁵ Thus patents obtained on inventions conceived during but patented after employment,²⁶ patents obtained during employment but prior to the execution of the assignment contract,²⁷ and patents obtained which relate to the employer's business but which are the result of private invention on the employee's own time,²⁸ have all been held subject to assignment to the employer. Inventions discovered by the employee prior or subsequent to his employment, however, have generally not been considered to be within the assignment requirements unless the employment agreement has so provided.²⁹ In addition, the employer-plaintiff has the burden of proving that the employee's invention is within the scope of his "business" as it is defined in the contract.³⁰

III. THE EMPLOYEE IS HIRED TO INVENT

Absent an express contract granting the employer an interest in any invention made by his employee, the general rule is to award the invention to the employee *in toto*.³¹ However, this practice is subject to an exception which is based upon an implied contract to grant the employer an interest

23. *Gas Tool Patents Corp. v. Mould*, 133 F.2d 815 (7th Cir. 1943); *Reece Folding Mach. Co. v. Fenwick*, 140 Fed. 287 (1st Cir. 1905).

24. *United States Colloid Mill Corp. v. Myers*, 6 F. Supp. 283 (S.D.N.Y. 1934).

25. *United States v. Dubilier Condenser Corp.*, 289 U.S. 178 (1933).

26. *New Jersey Zinc Co. v. Singmaster*, 71 F.2d 277 (2d Cir. 1934); *Fullman v. Steel City Elec. Co.*, 2 F.2d 4 (3d Cir. 1924).

27. *United Aircraft Products, Inc. v. Warrick*, 79 Ohio App. 165, 72 N.E.2d 669 (1945); *United Aircraft Products, Inc. v. Cruzan*, 76 Ohio App. 540, 62 N.E.2d 763 (1945).

28. *United States v. Houghton*, 20 F.2d 434 (D. Md. 1927), *aff'd*, 23 F.2d 386 (4th Cir. 1928); *Detroit Lubricator Co. v. Lavigne Mfg. Co.*, 151 Mich. 650, 115 N.W. 988 (1908). Also, the ownership of the employer's business may change from time to time. The employee is still bound to assign to the new owner. *Guth v. Minnesota Mining & Mfg. Co.*, 72 F.2d 385 (7th Cir. 1934), *cert. denied*, 294 U.S. 711 (1935). Intracompany transfers have no effect on the agreement. *Goodyear Tire & Rubber Co. v. Miller*, 14 F.2d 776 (S.D. Cal. 1926).

29. *Standard Plunger Elevator Co. v. Stokes*, 212 Fed. 893 (2d Cir. 1914). And where there is such a specific provision, it is strictly construed. *Gas Tool Patents Corp. v. Mould*, 133 F.2d 815 (7th Cir. 1943).

30. *Triumph Elec. Co. v. Thullen*, 228 Fed. 762 (E.D. Pa. 1916), *aff'd on other grounds*, 235 Fed. 74 (3d Cir. 1916).

31. *E.g.*, *Solomons v. United States*, 137 U.S. 342 (1890); *Howard v. Howe*, 61 F.2d 577 (7th Cir. 1932), *cert. denied*, 289 U.S. 731 (1933).

in future patented inventions.³² The exception applies where the employee is hired to invent, either in a general or specific area.

From such an employment relation, based on either a formal or an implied contract, the law implies an agreement by the employee to assign to his employer any future patent rights in inventions related to his employment and discovered during the term of employment.³³ This employment relationship may exist where the employee's entire job consists of inventing or where he is to solve only a particular problem requiring an inventive solution.³⁴ The employee in either case reasonably understands "that such inventions as resulted from his performance of the contract should belong to the employer, [and that] the employee is under an implied obligation to assign any patents acquired by him for said inventions to his employer."³⁵ Since there is an implied contract for the term of the employment, the employer need not have a prior specific agreement to assign any inventions,³⁶ and he can compel an assignment in equity.³⁷ In *Standard Parts Co. v. Peck*,³⁸ the leading case in the area, an employee was held not to have an interest in an automobile front spring that he had been hired to invent.³⁹

A situation requiring a difficult application of this theory exists where the employee is not hired to invent, but discovers an invention as a direct result of his employment. It has generally been held that such circumstances do not give rise to an implied contract to invent. In *United States v. Dubilier Condenser Corp.*,⁴⁰ the Supreme Court held that two government employees were under no obligation to assign patents on a radio device perfected by them, even though their invention was only an extension of their work in the development of remote control bombs and torpedoes. Another circumstance which creates difficulty in the interpretation of this

32. Perhaps one may conceive of another exception applicable to the narrow situation where the employee holds a peculiar position of trust in the company. Such would be the case where the employee pirates and patents an invention in his own name, after having been entrusted to manage the total operation of a company manufacturing the invention. See *Transparent Ruler Co. v. C-Thru Ruler Co.*, 129 Conn. 369, 28 A.2d 232 (1942). See also *Dowse v. Federal Rubber Co.*, 254 Fed. 308 (N.D. Ill. 1918).

33. The invention may be achieved on or off the job, but it must be in the employers line of business.

34. *E.g.*, *Goodyear Tire & Rubber Co. v. Miller*, 22 F.2d 353 (9th Cir. 1927) (general contract to invent); *Lion Mfg. Co. v. Chicago Flexible Shaft Co.*, 106 F.2d 930 (7th Cir. 1939) (having to develop a specific device). See 4 WALKER PATENTS §§ 375-76 (Deller 2d ed. 1964).

35. *National Development Co. v. Gray*, 316 Mass. 240, 55 N.E.2d 783, 787 (1944).

36. *Houghton v. United States*, 23 F.2d 386 (4th Cir. 1928), *cert. denied*, 277 U.S. 592 (1928).

37. *Tennessee Copper & Chem. Corp. v. Martin*, 4 F. Supp. 38 (D.N.J. 1932), *aff'd*, 66 F.2d 187 (3d Cir. 1933).

38. 264 U.S. 52 (1924). See 36 HARV. L. REV. 468 (1923). Another important Supreme Court case with this view is *United States v. Dubilier Condenser Corp.*, 289 U.S. 178 (1933).

39. *E.g.*, *Wireless Specialty Apparatus Co. v. Mica Condenser Co.*, 239 Mass. 158, 131 N.E. 307 (1921); *Air Reduction Co. v. Walker*, 118 Misc. 827, 195 N.Y. Supp. 120 (Sup. Ct. 1921).

40. 289 U.S. 178 (1933).

rule occurs where the employee is hired for his expertise in a certain field to aid in the development of the company's product. Here again, the law does not imply a contract of assignment.⁴¹

Court application of this doctrine places the burden of proof on the employer to show that there was in fact a hiring to invent,⁴² and there must be a very strong showing of favorable circumstances to imply such a contract.⁴³

IV. THE EMPLOYEE INVENTS USING THE EMPLOYER'S RESOURCES — THE SHOP-RIGHT DOCTRINE

Just as an employer may obtain an implied assignment of future patents by hiring an employee to invent, he may also obtain an implied license to use the employee's invention if the employee has utilized the employer's resources in the discovery.⁴⁴ This doctrine is based upon two theories. First, when an invention is discovered through the use of an employer's facilities, the employer as a matter of justice is entitled to free use of the invention.⁴⁵ The second theory finds an implied contract to grant a license to the employer, the consideration given by the employer being the use of his resources. However, since this latter basis is contractual, the employee-inventor must also assent to the employer's use.⁴⁶ It should be noted that in either case this shop-right of the employer is a mere license and not an assignment granting full title.⁴⁷ Neither is shop-right license an exclusive one;⁴⁸ others may be licensed by the patentee-employee. However, the

41. *American Circular Loom Co. v. Wilson*, 198 Mass. 182, 84 N.E. 133 (1908); *Gemco Engineering & Mfg. Co. v. Henderson*, 82 Ohio App. 324, 77 N.E.2d 742 (1947).

42. *Heywood-Wakefield Co. v. Small*, 87 F.2d 716 (1st Cir. 1937); *State Bd. of Education v. Bourne*, 150 Fla. 323, 7 So. 2d 838 (1942). Another courtroom rule, this one of evidence, is whether prior express assignments of the employee's invention justify the conclusion that he was hired to invent. It has been stated that this is conclusive evidence. *Magnetic Mfg. Co. v. Dings Magnetic Separator Co.*, 16 F.2d 739 (7th Cir. 1926), *cert. denied*, 274 U.S. 740 (1927). But the better view would limit the evidentiary force of this fact short of allowing it to be conclusive. See *Bowers v. Woodman*, 59 F.2d 727 (D. Mass. 1932); *Pressed Steel Car Co. v. Hansen*, 137 Fed. 403 (3d Cir. 1905), *cert. denied*, 199 U.S. 608 (1905).

43. *Howard v. Howe*, 61 F.2d 577 (7th Cir. 1932); *Gear Grinding Mach. Co. v. Stuber*, 282 Mich. 455, 276 N.W. 514 (1937).

44. This situation, where the employee actually achieves a patentable invention by discovering the scientific principle, should be distinguished from another possible situation where the employer uses only mechanical skill in giving form to his employer's principle. In such a case the employer, not the employee, is the inventor and has title, not a license. See *Agawan Woolen Co. v. Jordan*, 74 U.S. 563 (1898); *Pembroke v. Sulzer*, 265 Fed. 996 (D.C. Cir. 1920).

45. *United States v. Dubilier Condenser Corp.*, 289 U.S. 178 (1933).

46. *McClurg v. Kingsland*, 42 U.S. (1 How.) 187 (1843). As in *McClurg*, some cases allow this assent to be implied from circumstances, *e.g.*, the allowing of the employer to utilize the invention. Other cases have required an expressed assent. *Solomons v. United States*, 137 U.S. 342 (1890).

47. Whether an officer of a corporation may be considered an employee within the shop-right doctrine is subject to some disagreement. See *American Stoker Co. v. Underfeed Stoker Co. of America*, 182 Fed. 642 (W.D. Pa. 1910); *contra*, *Dalzell v. Dueber Watch Case Mfg. Co.*, 149 U.S. 319 (1893); *Detroit Testing Laboratory v. Robinson*, 221 Mich. 442, 191 N.W. 218 (1922).

48. *Solomons v. United States*, 137 U.S. 342 (1890).

license is presumed to be gratis⁴⁹ and it is up to the employee to show that the employer agreed to pay a royalty.⁵⁰

The shop-right doctrine is a doctrine of the common law initiated as far back as 1843 in *McClurg v. Kingsland*.⁵¹ In that case, suit was brought by assignees of the employee-patentees against the employer for infringement. The verdict was for the defendant on the ground that he possessed a license to use the invention (an improved method of casting metallic cylinders and cones) since it had been developed by using the employer's physical facilities and on the employer's time.⁵²

But while the shop-right theory may be easily and concisely stated as implying the grant of a license from an employee's use of his employer's facilities, the finding of a use sufficient to warrant the application of the rule in a particular situation involves a complex factual determination. The use of company time and materials has been deemed sufficient.⁵³ Utilization of the employer's tools, any labor assistance from fellow employees and company funds are other resources of the employer. In each case, the court must make a decision as to the equity of implying a license in the particular circumstances.⁵⁴

The employer's claim under the shop-right theory is limited to inventions applicable to his business⁵⁵ and it is coextensive only with his business requirements.⁵⁶ The shop-right is also limited in extent of time. In *Withington-Cooley Mfg. Co. v. Kinney*,⁵⁷ the court divided inventions into three categories: processes, machines for making articles or products for sale, and articles or products made for use or sale. Processes provide shop-rights for the life of the patent as do any inventions or articles made for use or sale. However, the invention of a machine permits a shop-right only to the use of that specific machine.

49. *Gill v. United States*, 160 U.S. 426 (1896); *Barry v. Crane Brothers Mfg. Co.*, 22 Fed. 396 (N.D. Ill. 1884); *contra*, *Deane v. Hodge*, 35 Minn. 146, 27 N.W. 917 (1886) (but this case is against the overwhelming weight of authority).

50. *Wilson v. American Circular Loom Co.*, 187 Fed. 840 (1st Cir. 1911).

51. 42 U.S. (1 How.) 187 (1843). The Court also based its decision on the fact that the employer had been allowed by the employees to utilize the invention and thus the employees had abandoned their exclusive patent rights.

52. For the shop-right doctrine in general, see ELLIS, *PATENT LICENSES* §§ 67-73 (Deller's ed. 1958).

53. *Pure Oil Co. v. Hyman*, 95 F.2d 22 (7th Cir. 1938). The use of company time, material and labor assistance was deemed sufficient in *Scott v. Madison Woolen Co.*, 3 F.2d 331 (S.D. Me. 1925).

54. "This is an application of equitable principles. Since the servant uses his masters time, facilities and materials to attain a concrete result, the latter is in equity entitled to use that which embodies his own property and to duplicate it as often as he may find occasion to employ similar appliances in his business." *United States v. Dubilier Condenser Corp.*, 289 U.S. 178, 188-89 (1933).

55. *Small v. Heywood-Wakefield Co.*, 13 F. Supp. 825 (D. Mass. 1936).

56. *Pure Oil v. Hyman*, 95 F.2d 22 (7th Cir. 1938). And where the patent obtained by the employee has other applications besides those in the employer's business, the shop-right only extends to the use in the employers business line. *Crites v. Radtke*, 28 F. Supp. 282 (S.D.N.Y. 1939).

57. 68 Fed. 500 (6th Cir. 1895).

Another limitation on the shop-right is its non-assignability. The license implied under the theory is a personal right of the employer's firm, and only the business-employer or his corporate successor may legitimately use the invention.⁵⁸ This prohibition on third-party assignment is consistent with the limiting of shop-right subject matter to the employer's business.

V. CONCLUSION

By focusing on the contract between the employee and his employer, and characterizing this relation into three main divisions, a body of law may be obtained capable of analyzing the many cases dealing with the conflicting patent claims of employers and employees.

An express contract between the parties will govern and require assignment by the employee. However, in the absence of an agreement regulating their conflicting interests, the employee and his employer must resort to case law to ascertain their patent rights. An employment contract to invent, either generally or as related to a particular problem, implies an agreement to assign resulting patent claims to the employer. A general employment contract has no such result, yet if the employee uses the resources of his employer, the shop-right doctrine implies a license in the employer. Absent the application of any of the above rules, the employee retains full and absolute title to the patent.⁵⁹

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58. *E.g.*, *General Point Corp. v. Kromer*, 68 F.2d 40 (10th Cir. 1933), *cert. denied*, 292 U.S. 623 (1934).

59. See RESTATEMENT (SECOND), AGENCY § 397 (1958). However, where an employer has adequately overcome his burden of establishing an interest in the employee's invention, the employee may still avail himself of two defenses — release or estoppel. The defense of a release, in this area as in any other, settles the controversy between the parties. So a release by which the employer relinquishes all rights and claims he has in the patent is a valid defense. See *Cahill v. Regan*, 5 N.Y.2d 292, 157 N.E.2d 505, 184 N.Y.S.2d 348 (1959). Estoppel obviously is also a doctrine not confined to the patent field. If the employer previously insisted that the invention was not made during the employment [*Texas Co. v. Gulf Refining Co.*, 26 F.2d 394 (5th Cir. 1928), *cert. denied*, 278 U.S. 625 (1928)], or where he rejects the invention [*Parker Rust-Proof Co. v. Allen*, 231 Mich. 69, 203 N.W. 890 (1925)], he is later estopped from claiming whatever rights he may have had.